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The Fleet Industry in 2010

The fleet industry had its ups and downs in 2009. With these and several other matters on the forefront of the industry, we can expect to see these trends continue to develop throughout 2010.

Interest Rate Forecast Positive

Last year at this time, the capital markets were virtually closed and liquidity was tight. The cost of capital was extremely high. Fast forward to today and liquidity has eased substantially, but the cost of capital is still relatively high. Even though interest rates remain at historic lows, the spreads continue to come down from their historical highs. It is anticipated that this trend will continue in the foreseeable future. But, most likely, the spreads on interest will never get back to where they were prior to the economic crisis.

Remarketing Environment - A Return to Fundamentals

2009 was a year of lessons that can be used to navigate through 2010. Used vehicle secondary market prices are impacted by many variables, but one main driver is new vehicle pricing.

There is a relationship between new vehicle prices and used vehicle values. As other variables change, the variance between new vehicle pricing and same model, used vehicle pricing can be stretched, compressed and even temporarily flipped. After economic and industry drivers normalize, the market will correct and the relationship will revert back toward the mean. Simply, used car values cannot go to zero nor will one-year-old wholesale values venture too close to new car values over an extended period. Secondary market prices will settle in a reasonable range between these two extremes.

Barring the re-emergence of major liquidity issues or a recession that results in rising unemployment and decreased consumer confidence, in 2010 we can expect used vehicle market levels to remain around historical averages with a decrease in volatility (monthly price movements) as favorable supply factors and demand stabilization are expected to continue.

Environmental Trends Continue

With gas prices on the rise again and fleets' biggest focus on managing and reducing fuel costs, there will be a renewed exposure on "green" matters. The focus of these initiatives will be driven by the triple bottom line principle where companies will factor in cost, functionality

and environmental impact of a vehicle in order to make their initiatives viable and sustainable.

With evolving vehicle technology becoming more affordable, we'll also see an increase in the availability of alternative fuel and electric vehicles. And cellulosic technology – a biofuel produced from wood, grasses or the non-edible parts of plants – is expected to grow. Under the U.S. Environmental Protection Agency's (EPA) guidelines, refiners are required to blend 100 million gallons of cellulosic biofuel in 2010, 250 million in 2011 and 500 million in 2012.

However, with the introduction of plug-in hybrid and electric vehicles, there may be a new way of calculating fuel efficiency that doesn't involve gallons, according to a Nov. 16, 2009, *Automotive News* article. An all-electric vehicle does not burn any petroleum to run, so it wouldn't get a miles per gallon rating simply because there aren't any gallons involved. Instead, we could adopt a method comparing the cost per 100 miles so that there is an understandable measure that can be used to compare vehicles across power sources.

Electric Vehicles – a Viable Alternative

Hundreds of thousands of electric vehicles (EV) will be on roadways within five years, according to the "Electric Vehicles: 10 Predictions for 2010," Pike Research white paper.

Despite rapid growth in the sale of plug-in hybrid electric vehicles and pure battery electric vehicles, the hybrid electric vehicle market will continue to be the largest market for the foreseeable future. This combined market for electrified vehicles will represent a small portion of the total vehicle market - just 2.5 percent.

Yet, it will require a multi-billion dollar investment in charging equipment and upgrades to the power grid to manage the additional load. In 2015, Pike Research forecasts charging stations will be available at more than 5.3 million locations worldwide.

Lithium ion battery manufacturers are gearing up for the EV age by building new manufacturing plants and expanding capacity to provide the necessary millions of cells and packs. Pike Research anticipates that this expansion will create an \$8 billion industry for batteries by 2015.

Alternative Fuel Potential Still a Mystery

The EPA may allow more ethanol, 15 percent, to be mixed with gasoline (current maximum is 10 percent). However, the EPA said in December

CONTACT US

Network
 1165 Sanctuary Parkway
 Suite 125
 Alpharetta, Georgia 30009
 Sales: (877) 921-3100
 Service: (800) 323-5916
www.thepowerofnetwork.com

that it needs more time to decide. They said they need to review test data on the effects a higher ethanol-gasoline ratio would have on vehicles. The Renewable Fuels Association, the trade group for ethanol producers, said the EPA's delay threatens the U.S. ethanol industry. The EPA is expected to make a final decision in mid-2010.

Yet, ethanol may not be the answer to our global warming problems. A recent study by Stanford University says that ethanol would likely worsen health problems caused by ozone, compared with gasoline. When ethanol is burned through combustion, it produces emissions that are substantially higher than gasoline in the carcinogenic precursors to ozone.

On the other hand, biodiesel demand is expected to double between 2009 and 2015, while supply is expected to grow threefold, according to *Biodiesel Magazine*. The driver for demand is not limited to the United States and Europe, also growing in the Asia-Pacific and Latin American regions. In fact, 30 countries are implementing biofuels targets in 2010.

Risk Management Focuses on Driver Distractions

The use of motor vehicle record checks (MVRs) is expected to increase. Running MVR checks can be a great way to proactively manage risk and ensure drivers stay safe and out of accidents.

However, cell phone use and distracted driving will continue to be a concern. Cell phone use is a major contributor to accidents, therefore, strict policies and ensuring adherence is extremely important, especially as more states enact bans on usage.

Expect more state and federal intervention. But, there is still uncertainty and unanswered questions around the way the laws should read and whether or not there should be exceptions.

Fuel Prices Close to \$3 Per Gallon

According to the U.S. Energy Information Administration (EIA), rising crude oil prices will contribute to a 20 percent increase in the annual average regular gasoline price from \$2.35 per gallon in 2009 to \$2.83 in 2010. In addition, pump prices may approach \$3 per gallon during this year's summer driving season. The projected annual average diesel fuel price is \$2.96 per gallon.

The EIA forecasts that world oil consumption will grow by 1.1 million barrels per day to 85.2 million per day in 2010. In a response to this anticipated rebound in global oil demand, projected OPEC crude oil production will increase to an average of 29.6 million barrels per day in 2010.

Rocky Road Ahead for Manufacturers

Roughly 10.1 million passenger vehicles will be built in North America in 2010. According to CSM Worldwide Inc., which provides automotive market forecasting to the automotive industry. That's an improvement from the estimated 8.5 million built in 2009. Unfortunately, a lack of available capital may still plague many suppliers.

The U.S. auto industry may be caught in an "airline-style" cycle of repetitive bankruptcies because of weak sales and a surplus of production capacity, according to Fitch Ratings, a global financial rating agency. Fitch says high fixed costs, the lengthy periods required to develop new products and chronic

overcapacity will leave the industry "littered with failures."

Nonetheless, Fitch is forecasting a 7.8 percent rise in U.S. light vehicle sales next year to 11.1 million units. But, the agency says that rebound will leave much of the industry burning cash.

Conversely, industry analyst John McElory says the future is bright for the domestic manufacturers, contingent upon the economy coming back. He says, for the first time in a long time, the Detroit 3 are in fighting shape for several reasons: slashed debt levels, reduced labor costs, fixed work rules, elimination of job banks, and no excess capacity.

Maintenance & Tire Prices Unpredictable

According to several Network national account vendors, there are not going to be any significant price increases this year. Because vendors are trying to be competitive in this tough economy, they do not want to scare away existing customers by increasing prices. Brakes and parts prices, as well as labor rates, should remain the same as last year.

On the other hand, there may be tire price changes. New tire sizes will come out that may be more expensive as the trend is moving toward larger tire sizes. The bigger the tire, the more material it takes to make the tire, causing the price to go up. In addition, production lines are being eliminated as manufacturers get away from their more affordable "house" brands. However, tire prices are a bit difficult to predict as production shifts from China and the effects of the tariff take hold. Consequently, costs may go up 3 percent to 4 percent, which we are already seeing.

The Road Ahead

News & Industry Trends

DOT Updates National Road Safety Standards

U.S. Transportation released an update to the Manual on Uniform Traffic Control Devices (MUTCD) on Dec. 16, 2009. Administered by the Federal Highway Administration since 1971, the manual sets the standards for road safety in the United States. The MUTCD's 2009 edition includes new and updated requirements, most of which were made as a result of extensive research. However, seven of them were recommended by the National Transportation Safety Board.

Among the new provisions in the MUTCD are:

- Replacing highway signs with brighter, larger and more legible ones easier to understand at freeway speeds.
- Adding different markings for lanes that do not continue beyond an intersection or interchange to give drivers more warning that they need to move out of the lane if they don't intend to turn.
- Expanding the use of flashing yellow arrow signals at some intersections to give a clearer indication that drivers can turn left after yielding to any opposing traffic.
- Changing the formula used to calculate crosswalk times to give walkers more time.
- Identifying electronic toll collection lanes with purple signs.
- Adding overhead lane-use control signs to reduce confusion among drivers in unfamiliar multi-lane roadways.

For more details about the changes, visit <http://mutcd.fhwa.dot.gov>.

Source: www.automotive-fleet.com, Dec. 23, 2009

California May Pull out of Fuel Economy Standard

California officials have threatened to pull out of the agreement between U.S. automakers and the Obama administration for a 35.5 mpg fuel economy standard by 2016. In a recent federal filing, the California Air Resources Board (CARB) said the Obama administration needs to address two concerns in the final rule, which is due March 31, in order "to ensure California's continued support."

CARB wants federal regulators to lower proposed credits for zero-emissions vehicles, which include hybrids, plug-in hybrids and electric vehicles. The proposed rule would count such vehicles as having no carbon emissions while using electric power, and give automakers a credit toward their overall fuel economy targets for each one built. They say the credits are too generous and could allow automakers to evade improvements in non-electric models. CARB also argues that electric vehicles contribute some greenhouse gases because they draw electricity from carbon-generating power plants.

California regulators also want the administration to reject a proposal to ease the phase-in of the standards between 2012 and 2015, with a larger increase for the 2016 model year to reach the 35.5 mpg target.

This has caused anxiety for Detroit automakers that the state could decide to enforce its own rules concerning vehicle greenhouse gas emissions. As a result, it could start a trend of state-by-state laws rather than the national standards set by the government.

Source: *Detroit Free Press*, Jan. 20, 2010